



The Commonwealth of Massachusetts

DEPARTMENT OF PUBLIC UTILITIES

D.P.U. 15-40

April 9, 2015

Investigation by the Department of Public Utilities on its own Motion into the Provision of Basic Service.

VOTE AND ORDER OPENING INVESTIGATION

I. INTRODUCTION

In recent months, Massachusetts ratepayers have experienced significant increases in basic service electricity prices. These increases are the result of regional energy market dynamics and do not reflect increases in the electric distribution company¹ rates that the Department of Public Utilities (“Department”) fully regulates.² Nonetheless the Department is very concerned about such price impacts on customers and is committed to exploring any opportunity to mitigate such increases or their effects on customers. In addition, in recent years, Massachusetts distribution companies have experienced declining participation by wholesale suppliers to basic service solicitations, particularly for medium and large commercial and industrial (“C&I”) customers, with potential negative impacts for customers.

To address these issues, the Department opens an investigation into the pricing and procurement of basic service. This Order provides further background on these issues and lays out three potential actions for consideration in this proceeding.

¹ The electric distribution companies that are subject to the Department’s jurisdiction are: Fitchburg Gas and Electric Light Company d/b/a/ Unitil (“Unitil”), Massachusetts Electric Company and Nantucket Electric Company each d/b/a/ National Grid (“National Grid”), NSTAR Electric Company (“NSTAR Electric”), and Western Massachusetts Company (“WMECo” together with NSTAR Electric each d/b/a Eversource Energy).

² The Department fully regulates the rates charged by electric distribution companies for the local delivery of electricity to retail customers.

II. BACKGROUND

In 1997, the Legislature changed the manner in which electric service is provided to consumers in the Commonwealth with the enactment of the Electric Restructuring Act.³ In the restructured electric industry, consumers have the option of selecting an entity other than the incumbent electric company, to provide the supply component of retail electric service. For customers that do not select a competitive entity to provide their retail electric supply service, the electric distribution companies provide basic service.

The Electric Restructuring Act requires (1) that each distribution company provide basic service;⁴ (2) that basic service be competitively procured; (3) that the basic service rate “shall not exceed the average monthly market price of electricity;” and (4) that bids to supply basic service “shall include payment options with rates that remain uniform for periods of up to six months.” G.L. c. 164, § 1B(d). In 1999, the Department opened an investigation into the pricing and procurement of basic service in order to determine the average monthly market

³ “An Act Relative to Restructuring the Electric Industry in the Commonwealth, Regulating the Provision of Electricity and Other Services, and Promoting Enhanced Consumer Protection Therein.” St. 1997, c. 164.

⁴ The Electric Restructuring Act uses the term “default service” rather than “basic service.” St. 1997, c. 164, § 187. In Default Service Procurement, D.T.E. 04-115-A (2005), the Department determined that the term “default service” was confusing some customers because of its unintended suggestion of nonfeasance. D.T.E. 04-115-A at 4. The Department found that the term “basic service” appropriately defines the nature of the service being provided by distribution companies without being confusing, misleading, or anticompetitive. Thus, the Department directed distribution companies to refer to the service provided by it after March 1, 2005 as “basic service.” Subsequent legislation added the definition of basic service. See St. 2008, c. 169, § 57; G.L. c. 164, § 1. Throughout this Order, we use the term basic service rather than default service.

price of electricity and to determine how this price should be incorporated in the basic service rate. Pricing and Procurement of Default Service, D.T.E. 99-60 (1999). In 2002, the Department opened an investigation into the pricing and procurement of basic service in order to ensure that the manner in which basic service is provided is compatible with the development of an efficient competitive market in Massachusetts. Pricing and Procurement of Default Service, D.T.E. 02-40 (2002). The Department specifically evaluated policies in the following three areas (1) the price components to be included in basic service rates, including administrative and bad debt costs and the effects of locational marginal pricing; (2) basic service pricing options; and (3) procurement schedules and strategies. D.T.E. 02-40, at 5-6.

Pursuant to the Department's directives, the electric distribution companies procure basic service by conducting competitive solicitations (1) every six months to procure 50 percent of the supply requirement for one year for their residential and small C&I customers, and (2) every three months to procure 100 percent of the supply requirement for three months for their medium and large C&I basic service customers. See D.T.E. 02-40-C at 18-25 (2003).

In these procurements, wholesale electricity suppliers submit bids to provide "all requirements service" for the applicable basic service term, with bid prices identified separately for each month of the term. As providers of all requirements service, suppliers are responsible for providing the energy, capacity, ancillary services, and any other services or products necessary to serve 100 percent of the load, delivered to a specified point on the electric distribution company's system. Thus, each supplier's bid price is based on its

projected costs to supply the products described above, taking into account its responsibility to provide supply for all basic service load, regardless of increases or decreases in load over the term. The distribution companies take a weighted average of the monthly bid prices to establish a fixed price basic service option, in addition to an option where prices change each month. Residential and small C&I customers are placed on a six-month fixed price option and medium and large C&I customers are placed on the variable monthly rate option; all customers have the opportunity to change their pricing option. D.T.E. 02-40-B at 33-34 (2003).

The basic service rate is set as a “pass through” of the market costs of electricity supply to customers; electric distribution companies do not earn a return on or derive a profit from providing basic service. See G.L. c. 164, § 1B(d).⁵ The Department reviews an electric distribution company’s basic service solicitation to ensure that it is competitive and that the resulting rates are appropriately market based. D.T.E. 02-40-C at 22-23.

The Department also established the basic service reconciliation mechanism whereby any over- or under-recoveries of basic service costs are recovered from all distribution customers. D.T.E. 99-60-C at 10, 13 (2000).⁶ The Department determined that basic service cost over- or under-recoveries should be spread among all distribution customers for two

⁵ See also, D.T.E. 99-60-B (2000); D.T.E. 02-40-B at 22-23; D.T.E. 02-40-C at 22-23.

⁶ For customers on the monthly pricing option, differences between costs and revenue may occur because suppliers are paid on a calendar month basis, while customers are billed on a billing cycle basis. For customers on the fixed price option, differences between costs and revenue may occur because the fixed price is calculated as the weighted average of the monthly prices, based on the projected monthly basic service load during the term. D.T.E. 99-60-C at 10.

reasons: (1) basic service acts as insurance for customers who enter the competitive market, and thus all customers benefit from the safety net provided by the existence of basic service; and (2) although the basic service reconciliation ideally should be recovered from, or refunded to, the customers that cause the costs, it is difficult to do so because the number of customers on default service at one time may constantly change. D.T.E. 99-60-C at 13.

The Department's previous Orders on basic service pricing and procurement have sought to promote the development of an efficient competitive market in Massachusetts, while also recognizing that different basic service pricing and terms (and therefore procurements) are appropriate for different customer classes. See, D.T.E. 02-40-B at 36, 44. For example, the Department determined that it was appropriate that the pricing and procurement for residential and small C&I customers should ensure reasonable and stable prices for these customers, whereas for medium and large customers, basic service should serve more as a short-term, last resort service, reflecting market prices to a greater extent. D.T.E. 02-40-B at 36-40, 44-45. One of the main reasons for this distinction in D.T.E. 02-40-B was that the different customer classes had widely varying levels of participation in the competitive supply market. This dynamic still largely applies today, as medium and large C&I customers primarily receive their generation service from the competitive supply market, while the vast majority of residential and small C&I customers rely on basic service.

The Department has recently taken a number of steps to enhance the value that residential and small C&I customers receive from the competitive electric supply market, including a proceeding aimed at (1) removing barriers to participation in the competitive

market; (2) providing customers with information regarding competitive supply products that is accurate, transparent, and understandable; and (3) improving customer protections related to the marketing and delivery of competitive suppliers' product offerings. See Initiatives to Improve the Retail Electric Competitive Supply Market, D.P.U. 14-140, at 1 (2014).⁷ In addition, last year the Department established a program for electric distribution companies to purchase the receivables of competitive suppliers for the amounts owed to the suppliers by their retail electric customers who are billed under the complete billing method. Investigation Regarding Purchase of Receivables, D.P.U. 10-53-C/D/E (2014). Purchase of receivables programs are intended to reduce the barriers that competitive suppliers face in entering the competitive retail market, thereby increasing the number of market participants and enhancing retail competition to achieve benefits for customers. D.P.U. 10-53-C/D/E at 4.

While the Department anticipates an increase in participation in the competitive supply market as a result of its recent actions, we expect that, at least in the near future, a significant portion of residential and small C&I customers will continue to receive their generation service through basic service supply.

⁷ In its Order opening this proceeding, the Department outlined five initiatives: (1) developing a "shopping for competitive supply" website; (2) revising the existing information disclosure label; (3) eliminating the basic service bill recalculation provision for residential and small C&I customers; (4) establishing reporting requirements for door to door marketing; and (5) establishing reporting requirements and rules for the assignment of customers to another competitive supplier. D.P.U. 14-140, at 1.

III. CURRENT ISSUES AFFECTING BASIC SERVICE

A. High Costs

In recent years the wholesale cost of electricity in New England has significantly increased during winter months. In the 2014-2015 winter season, customers faced the highest basic service electricity prices since passage of the Electric Restructuring Act. The following table lists the recent prices for residential and small C&I customers over the past two years.⁸ Similar price trends also occurred for larger customer groups.

Recent Residential Fixed Basic Service Prices (cents per kilowatt hour)				
	“Summer” 2013	“Winter” 2013-2014	“Summer” 2014	“Winter” 2014-2015
National Grid	7.251	10.025	8.277	16.273
NSTAR Electric	7.506	9.330	9.379	15.046
WMECo	8.317	8.174	8.844	14.288
Unitil	7.851	9.276	8.485	14.090

In response to the unprecedented basic service rates filed with the Department by National Grid in the fall of 2014,⁹ at the request of the Attorney General of the Commonwealth, the Department investigated options for mitigating the impact of such rate increases by deferring a portion of cost recovery to a future residential basic service term or by

⁸ Procurement and terms are staggered among the distribution companies. National Grid’s fixed price terms for residential customers run from November to April and May to October; NSTAR Electric’s and WMECo’s terms run from January to June and July to December; and Unitil’s terms run from December to May and June to November. Staggered procurements contribute to differences in fixed prices based on the months procured due to varying costs.

⁹ National Grid was the first distribution company to file its 2014-2015 winter prices based on a predetermined schedule.

other means. Massachusetts Electric Company and Nantucket Electric Company,

D.P.U. 14-BSF-D3-A. After review and consideration of comments, the Department concluded that such a deferral would not be in the public interest. The Department found that recalculating National Grid's basic service rate might have unintended consequences, including increasing the price of future basic service bids due to increased regulatory risk for suppliers, and increasing costs to non-basic service customers as well as higher costs for National Grid ratepayers as a result of adding carrying costs. D.P.U. 14-BSF-D3-A at 15-16 (2014).

Recognizing that higher winter electric rates would be a challenge for electric distribution companies' customers, the Department directed the electric distribution companies to take several actions to mitigate their effects, including to offer budget billing¹⁰ throughout the winter months, continue to educate customers about the competitive supply market, and implement targeted energy efficiency programs, particularly for low-income and electric space heating customers. D.P.U. 14-BSF-D3-A at 14-16. The Department notes that this investigation occurred in the context of specific solicitation results and was therefore limited in scope. By contrast, the current investigation considers the full range of options regarding the procurement and pricing of basic service.

¹⁰ A budget billing plan is an equalized payment arrangement whereby the customer's electric usage is projected for a period, equal monthly charges are calculated and billed for that period, and said charges are reconciled with actual usage in the final billing for said period. 220 C.M.R. § 25.01(2).

B. Limited Response to Basic Service Solicitations

In addition to high basic service prices, the second issue the Department will investigate in this proceeding is that distribution companies have seen a decreased response to solicitations for basic service supply, particularly for medium and large C&I customers. In 2014, as a result of a significant decrease in bidder participation for medium and large C&I customers, Eversource and National Grid filed with the Department alternative proposals for procuring supply for these basic service customers in the event that the companies do not secure a competitive bid (referred to herein as “Eversource Alternative Plan” and “Grid Contingency Plan”). Unitil has in place an alternative method for procuring supply for its large C&I customers. Fitchburg Gas and Electric Light Company, D.P.U. 11-16 (2012).

Under these alternative approaches, the companies proposed to directly procure electricity through the ISO New England Inc. (“ISO-NE”) wholesale energy markets (See, e.g., D.P.U. 11-16, at 6-7; Eversource Alternative Plan, at 5; Grid Contingency Plan, at 3). However, the approaches vary significantly in several ways, such as: whether prices are established before delivery of the electricity or calculated after the fact based on actual market costs; whether the risk associated with the differences between projected and actual market costs are borne by the specific customers being served or by all distribution customers through the basic service reconciliation mechanism; and whether the energy is procured in day-ahead or real time ISO-NE markets.

Below, the Department identifies possible changes to basic service procurement and pricing to mitigate low participation in solicitations. In addition, the Department will

investigate the different distribution company approaches to procuring supply for customers in the absence of successful competitive solicitations.

IV. FRAMEWORK FOR INVESTIGATION

To address the challenges of high basic service prices and limited supplier response to solicitations, the Department puts forth for consideration three potential changes to basic service pricing and procurement: (1) adopting a more “layered” approach to the procurement of basic service supply; (2) providing the distribution companies with greater discretion and flexibility in their basic service supply procurement practices; and (3) changing the “all requirements” obligation currently placed on basic service suppliers.

A. A More Layered Approach to Procuring Basic Service

First, the Department will explore the possibility of a more layered approach to basic service. As described above, the electric distribution companies procure basic service supply through competitive solicitations every six months for 50 percent of the load for one year for their residential and small C&I customers. Basic Service rates for these customers are based on the results of these solicitations. See D.T.E. 02-40-C at 18-25. In D.T.E.02-40-B, the Department found that the procurement schedule described above strikes an appropriate balance between providing price stability for residential and small C&I customers, and providing these customers with efficient price signals. D.T.E. 02-40-B at 44.

Another proposal considered by the Department in D.T.E. 02-40-B included a procurement schedule that involved a greater number of solicitations. D.T.E. 02-40-B at 41. We now consider an approach, described herein as “layering,” that involves many

solicitations, conducted at various times for varying length, layered together in order to provide greater price stability for customers. We note that Rhode Island currently uses this sort of procurement approach for standard offer service, Rhode Island's equivalent of basic service.¹¹

B. Distribution Company Discretion and Flexibility

Next, the Department puts forth whether electric distribution companies should have greater flexibility and discretion in procuring basic service supply. Currently in Massachusetts, electric distribution companies issue solicitations at predetermined times for predetermined terms. By allowing electric distribution companies to structure solicitations, pricing options, and the terms of service based on current market conditions, companies may be able to reduce prices by customizing their procurement strategy.¹² However, any consideration of allowing greater flexibility to procuring basic service supply must take into account potential negative impacts on the competitive retail supply market.

C. Changing "All Requirements" Obligation

The third broad change put forth for consideration in this investigation involves alternatives to an "all requirements" approach as described in Section IIA above. This type of change may be particularly suitable to address the issue of decreased participation in basic service solicitations for larger customers. The Department puts forth two approaches.

¹¹ See, e.g., RI PUC Docket No. 4393, available at <http://www.ripuc.org/eventsactions/docket/4393page.html>

¹² In Rhode Island, for example, the electric distribution company is required to propose a procurement schedule and strategy for approval to the public utility commission on an annual basis. R.I. Gen. Laws § 39-1-27.8.

The first approach is through the distribution companies' procuring basic service supply in the ISO-NE wholesale energy markets. This approach is embodied in the methods for procurement used by Unitil for large C&I customers and described in the contingency plans put forth by Eversource and National Grid, described in Section IIIB above. As part of this investigation, the Department will assess these different approaches, including specific elements, such as the allocation of risk from variations in wholesale market prices and procurement through the day ahead versus real time ISO-NE markets.

The second possible approach to altering the all-requirements obligation involves changing the parameters set forth regarding the solicitations themselves. For example, this could include insulating suppliers from fluctuations in basic service load beyond a certain level. Alternatively, this approach could involve the distribution companies' procuring multiple alternatives to all-requirements service, which would pose less risk for suppliers (e.g., tranches of firm supply, tranches of products allowing more flexible purchases, and tranches of products designed to accommodate highly uncertain load requirements, such as call options).

V. NEXT STEP IN PROCESS AND PARTICIPATION

As the next step in this investigation, the Department will conduct a technical conference on Tuesday, May 19, 2015 at 10:00 a.m. in the New England Room at the Federal Reserve Building, 600 Atlantic Avenue, Boston, Massachusetts. At the technical conference, the Department will address issues discussed in this Order. To that end, the Department directs the distribution companies to make two presentations. The first presentation will address procurement practices that their affiliated distribution companies use in other states,

particularly those that embody the alternatives discussed above (e.g., for National Grid, Rhode Island and New York; for Eversource, Connecticut; for Unitil, New Hampshire). The second presentation will summarize the distribution companies' current alternate procurement practices or proposals for large customers. In addition, any interested party is invited to make proposals or presentations regarding any of the issues described in this Order, including to offer additional pricing and procurement proposals or to advocate against possible changes. In particular, we seek input from competitive suppliers active in states with different basic service procurement practices, in order to learn about the impacts on their business from these practices. All the presentations are intended to provide the basis for discussion regarding issues such as potential benefits and costs to ratepayers, allocation of risk, and potential impacts of changes to basic service procurement on the competitive supply markets. Parties that wish to make such presentations must contact hearing officer Elizabeth Lydon by May 5, 2015. Presentations will be shared with all stakeholders at least three business days before the technical conference, on Thursday, May 14, 2015.

Any person interested in participating in this investigation should indicate such interest by informing Department Secretary Mark D. Marini, via email (mark.marini@state.ma.us) or by postal mail (Mark D. Marini, Secretary, Department of Public Utilities, One South Station, Boston, Massachusetts 02110), no later than May 1, 2015. To be included on the service list for this investigation, the request to the Secretary must include the following information: (1) name and organization represented, if any; (2) address; (3) telephone number; and (4) email address.

VI. ORDER

Accordingly, the Department

VOTES: To open an investigation into the provision of basic service in the Commonwealth; and it is

ORDERED: That the Secretary of the Department shall publish notice of this investigation in a statewide paper of daily circulation within the Commonwealth and shall serve a copy of such notice upon all persons on the Department's official service list; and it is

